

Eesti Pank  
Bank of Estonia



# LABOUR MARKET REVIEW

**2**/2010

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## **MAIN DEVELOPMENTS IN THE FIRST HALF OF 2010**

This review focuses on developments in the Estonian labour market in the first half of 2010, during which period the first signs of recovery appeared after the decline in economic growth had bottomed out. The economic crisis reached depths that were unprecedented in Estonia and the precise course of the recovery still remains unclear, and there were major changes in the labour market to the number of jobs, the length of the working day, pay and legislation. These changes permitted relatively rapid and substantial cutbacks in labour costs and helped create a stronger foundation for profit growth once productivity drives economic growth to recover.

Trends in labour market indicators remained in line with cyclical economic developments and followed the changes with a two-quarter delay, so that while the economy bottomed out in the third quarter of 2009, the number of people in work reached its lowest level in the first quarter of 2010. The delay in the correction in labour costs meant that the period of continued decline saw a rapid drop in productivity and an increase in unit labour costs; the recovery shows signs of dynamic productivity growth and falling unit labour costs.

The economic decline and the fall in numbers of jobs mostly affected the construction sector, which had grown rapidly, and several branches of manufacturing, increasing the threat of structural unemployment. This means that more measures must be taken to provide retraining and to eliminate structural gaps. In the near future, structural unemployment needs to be reduced as much as possible.

Cuts in wages and the number of working hours in response to the sudden drop in demand have helped Estonia avoid an even greater fall in employment. However, the new economic cycle starting with the recovery of growth entails slightly different risks. As reserves are so high, the economic recovery will initially lead only to an increase in the number of working hours per employee, but not to a rise in the number employed. When resources are under-utilised it is easier to achieve output growth through productivity rises, calculated both per hour worked and per person employed. The Organisation for Economic Cooperation and Development (OECD) believes that economic growth may recover in its member countries during the next two years without any significant growth in the number of jobs, which means that the rapid rises in unemployment will not be reversed, long-term unemployment will continue to grow, and the quality of the available labour force will drop.

This will entail changes in economic policy goals. It is crucial that appropriate macroeconomic

policies be chosen and the sustainability of the budget guaranteed, but while combating the effects of the crisis we should increasingly focus on creating the foundations for future economic growth. As the fiscal situation remains tense, labour market policy measures must be used more effectively and the advisability of financing them must be linked to the results they can achieve. The bottleneck in the labour market is poor skills, for instance in computers, account keeping and languages, meaning the education system should focus on its target groups more effectively. People must be given an incentive to learn, and this means connecting the benefits system to studying, job seeking and readiness for employment. Subsidised jobs should also be replaced with more sustainable ones.

## LABOUR SUPPLY AND DEMAND

### Labour force participation and economic inactivity

Labour supply, or the economic activity of the labour force, remained high despite the ongoing drop in demand for labour. In the first quarter of 2010, the number unemployed rose to 136,900 (see Figure 1). In addition to the drop in employment, the number of unemployed was boosted by a fall of 7,300 from the fourth quarter of 2009 in the number inactive. The number of people inactive because of studies and discouragement fell.

In the first quarter of 2010, the total number of people aged 15–74 shrank by 4,000, but according to the labour survey, the labour supply fell by only 600 compared to the same period

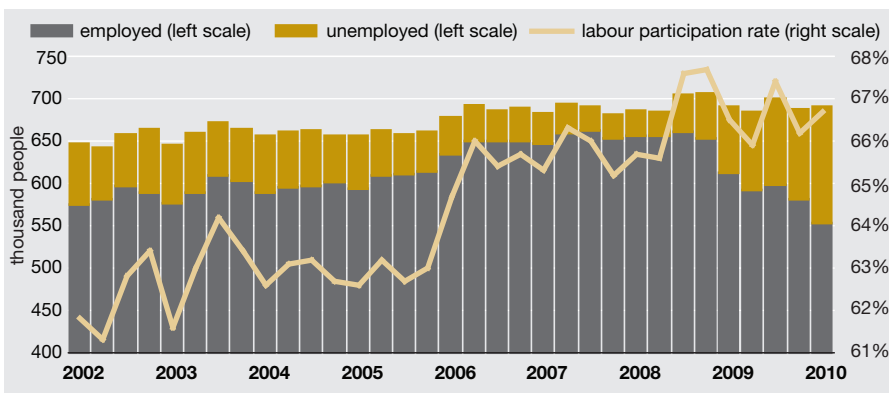


Figure 1. Number of the employed, the unemployed and the labour participation rate

of the previous year. This meant the number of people inactive<sup>1</sup> fell by 3,400 and the labour participation rate<sup>2</sup> for people aged 15–74 rose to 66.7%, which is 0.2 percentage points more than a year previously.

The total number and structure of the inactive was strongly influenced by demographic changes, especially among the young and the elderly (see Background Information 1).

### **Background Information 1. Implications of demographic changes for labour force participation**

The rate of labour participation, which shows activity, and the number of economically active people have been increasing almost constantly during the past five years, even though the working age population (aged 15–74) has been shrinking. One hypothesis is that this was a temporary phenomenon related to the economic boom and that during the period of slower economic growth the labour participation rate should fall back to its pre-boom level. Another hypothesis is that the activity growth in the working age population is permanent and will continue in the future. It is important to note here that the age structure of the working age population of Estonia has changed relatively rapidly in recent years. The number of young people has been affected by the entry of the so-called singing revolution generation to the labour market and their increasing activity, while the age structure of the elderly has been impacted by the withdrawal from the labour market of a relatively small generation born during and after the war.

For instance, in 2010 the number of school-aged young people aged 15–20 living in Estonia dropped by almost 9,000 from the previous year, while the number of economically more active people aged 21–23 grew by almost 1,000. Changes among the elderly were also extensive as the more passive segment aged 64–74 shrank by almost 2,000, while the number of more active people aged 62–63 increased by about 4,000. In total this meant that while the total number of people aged 15–74 dropped by 4,000 within one year, the number of people aged 21–63, who are more active in the labour market, grew by 6,600. Thus, demographic changes may have significantly affected the labour participation rate.

<sup>1</sup> A person is inactive when he/she neither works nor is looking for work, for example the retired, students, homemakers and the discouraged.

<sup>2</sup> The labour participation rate gives the share of the employed and unemployed in the working age population.

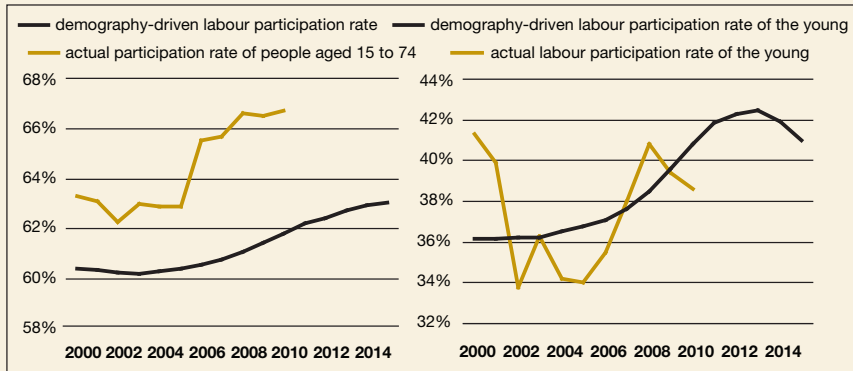
By using the data for labour participation from the census of 2000, which shows activity for five-year age groups (15–19, 20–24), as fixed weights, we calculated a theoretical number of labour force participants which would be given by changes in demographic composition alone.

**Table 1. Census in 2000**

	<b>Total population</b>	<b>Economically active</b>	<b>Activity rate</b>
15–74	1,046,291	631,918	60.4
15–19	103,772	11,789	11.4
20–24	94,648	59,941	63.3
25–29	94,433	75,353	79.8
30–34	89,336	75,072	84.0
35–39	96,623	83,957	86.9
40–44	99,434	87,352	87.8
45–49	95,069	82,069	86.3
50–54	85,760	70,030	81.7
55–59	74,163	46,626	62.9
60–64	82,746	27,405	33.1
65–69	69,442	9,172	13.2
70–74	60,865	3,152	5.2

The results of the calculation show that in recent years, demographic changes have significantly affected the labour participation of the working age population, especially the young. For instance, over the past seven years the activity rate for people aged 15–74 has increased by 1.6 percentage points because of changes in age structure alone. In fact, activity grew even more than this, by 3.7 percentage points, but the impact of demographic changes was discernible, accounting for 43% of the change. The rate of labour participation was also affected by the gradual rise in the age of retirement in these years.

The change in the age structure of people aged 15–24 almost fully explains the increase in the labour participation rate during 2003–2009. In 2010, the actual activity rate of the young has decreased (see Figure 2). Given future demographic changes, the activity rate of the young may also continue to grow in the next few years, but their numbers will start dropping next year.



**Figure 2. Impact of age structure changes on the labour participation rate**

In 2010, the labour force has grown older again as the number of the young (aged 15–24) has dropped by 8,200 over the year, the number of the middle-aged (aged 25–49) has remained almost the same and that of the elderly (aged 50–74) has increased by 3,200.

In the first quarter, the number of discouraged people who have lost hope of finding a job dropped by 3,600 to 6,900, quarter-on-quarter. It is difficult to say whether this was caused by increased hopes of finding a job or the increased risk of poverty, but the fall in the number of the discouraged is generally positive because these are people who it is difficult to bring back to the labour market.

### **Employment**

The number of people employed continued to drop in the first quarter of 2010, down by 9.6% or 58,500 over a year, which is slightly less than in the three previous quarters, but still high. Compared to the fourth quarter of 2009, the numbers employed dropped by 26,900; in construction the number of jobs fell by 15,000 and in manufacturing by 13,800. This may partially have been caused by the cold winter.

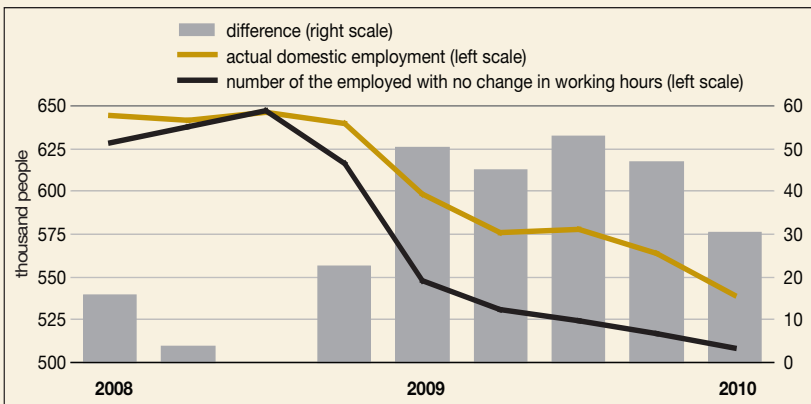
Year-on-year, the fall in employment significantly outpaced that in the economy, which was 2.0%. This indicates rapid growth in productivity and the ongoing reorganisation

of production processes. Relatively flexible wages and cuts in the number of working hours during the sudden drop in demand helped Estonia to avoid an even greater fall in employment (see Background Information 2).

**Background Information 2. The impact of changes in working hours on employment and unemployment indicators**

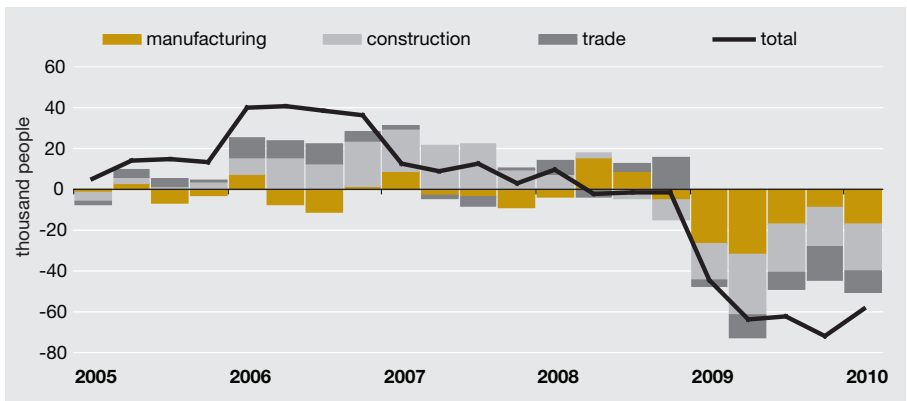
A key measure to curb labour costs during the rapid economic decline was the reduction in the number of working hours per employee created by part-time working schedules or unpaid holidays. Without this, the drop in employment and rise in unemployment would have been even faster. Had the number of working hours remained the same, the number of the employed would have dropped below 550,000 as early as the first quarter of 2009. In the third quarter of 2009, at the bottom of the economic decline, the number of the employed would have fallen by 122,000 instead of 69,000, or 1.8 times as many (see Figure 3). The unemployed would have numbered nearly 130,000 a year earlier, in the first quarter of 2009, and in the first quarter of 2010 they would have exceeded 167,000.

However, the same factors also inhibit employment growth when the economy is recovering. In the first quarter of 2010, the number of working hours per employed person increased by 3% year-on-year. Had the working hours not been reduced in the meantime, the drop in employment would have been even larger.



**Figure 3. Hypothetic number of the employed with no change in working hours**

In the first quarter of 2010, the number of people in work fell to 553,600, which is the lowest it has been in the past 20 years. Altogether 102,900 jobs disappeared in two years of crisis, 43,700 of them in manufacturing and 41,000 in construction (see Figure 4). In trade, the number of jobs dropped by 12,500 over two years and in real estate management by 4,300.



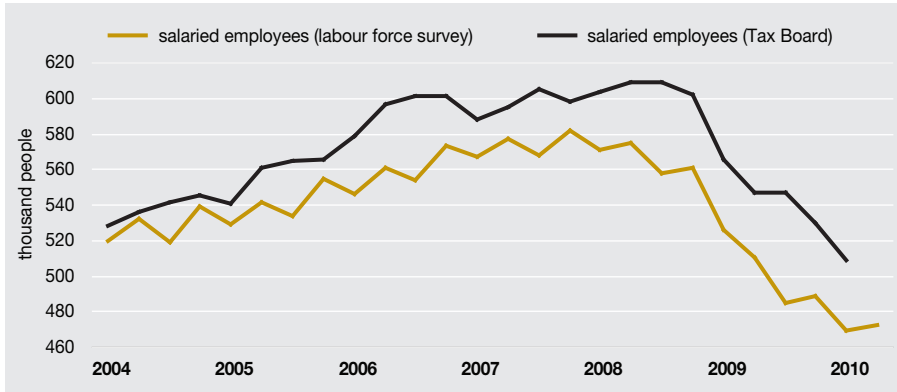
**Figure 4. Change in employment by fields of activity**

As the major changes did not affect all areas of activity alike, the structure of employment changed greatly. Over the past two years people working in construction as a share of total employment dropped by 5.1 percentage points from 12.4% in the first quarter of 2008 to 7.3% in the first quarter of 2010, and the share of people working in manufacturing dropped by 3.9 percentage points from 21.3% to 17.4%.

There are several statistical assessments of the number of salaried employees. The highest number of salaried employees is recorded in the labour survey, which counted 509,000 in the first quarter and includes part-time employees, people working abroad and salaried employees who did not receive wage payments or did not declare them during this period. The Tax and Customs Board posted a smaller number of salaried employees, recording 469,624 in the first quarter, and including only those employees who actually received salaries during the period and who declared them to the Tax and Customs Board (see Figure 5).

The spread between these two indicators increased dramatically in the third quarter of 2009, from 38,000 in the first half-year to 62,000. This indicates problems with wage payments and an increase in concealed employment relations or work abroad. In the following quarters, however, this spread shrank, to 41,000 in the fourth quarter of 2009 and to 39,000 in the first quarter





**Figure 5. Salaried employees**

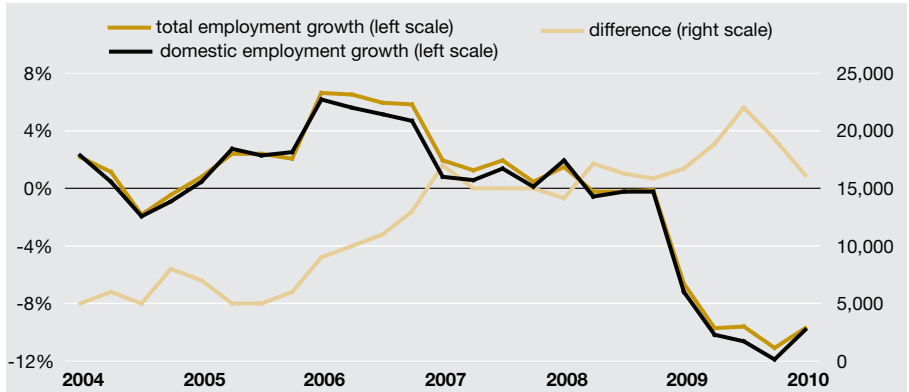
of 2010, meaning that the situation has improved slightly. The data available for April and May suggest that the lowest number of salaried employees was reached in the first quarter of this year and it will not drop significantly in the future.

As the economic decline stabilised, the number of full-time employees and the underemployed fell most in the first quarter of 2010, by 10.3% and 13% year-on-year respectively. The number of people working part-time on their own account did not change notably over the year. The share of full-time employees in employment thus fell by 0.8 percentage points to 88.8% year-on-year.

Breaking employment down into domestic and total employment<sup>3</sup> gives a difference that indicates net emigration, showing the number of Estonian residents working abroad minus the number of residents of other countries working in Estonia. As the economic decline deepened, Estonian residents became more interested in working abroad. In the third quarter of 2009, the number of Estonian residents working abroad rose faster than before and the spread between domestic and total employment increased to 22,000. Despite fears to the contrary, net emigration stopped growing in the following periods, and instead, in the fourth quarter of 2009, the spread between domestic and total employment dropped to 19,000 and in the first quarter of 2010 to 16,000.

In other words, when the economic decline was at its worst the number of people working abroad grew by 35%, but in the first quarter of this year it fell by 3.6% (see Figure 6). It is

<sup>3</sup> Total employment is both domestic employment and Estonian residents working abroad; it does not include non-resident foreigners working in Estonia.



**Figure 6. Total and domestic employment**

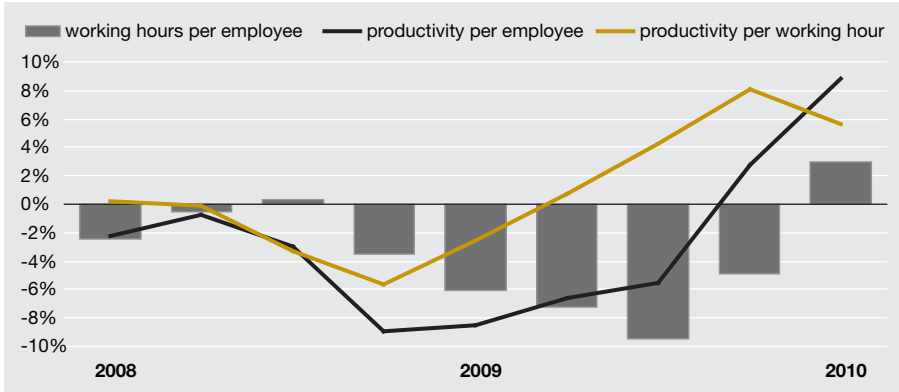
Source: Eurostat, author's calculations

possible that finding and keeping a permanent job abroad has become more difficult due to the shrinking demand, but equally the return of people to the local labour market may reflect their increasing confidence in finding employment in Estonia.

### Labour productivity

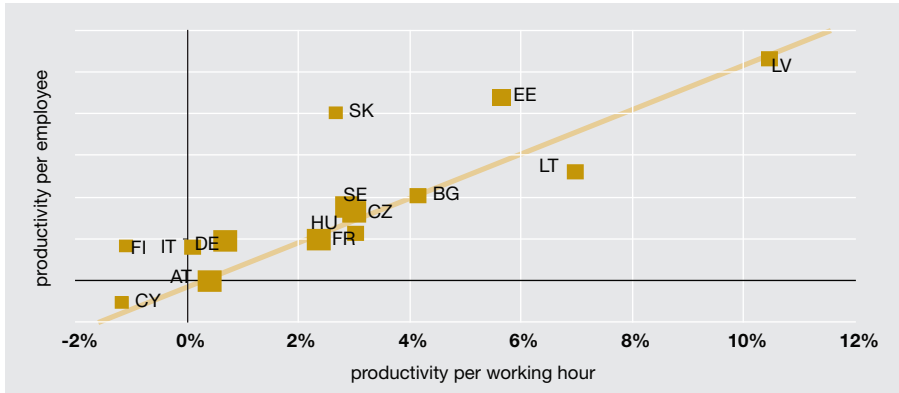
Employment and wage trends always lag behind changes in the economy. As a result, in times of decelerating economic growth or accelerating decline, labour productivity indicators kept falling. When the economy stabilised in the second half of 2009 however, labour productivity indicators showed some first positive signs. As many companies have used reduced working hours, part-time employment and partially paid vacations instead of lay-offs, the drop in hourly productivity remained smaller and the reaction to economic developments swifter. Productivity per working hour started improving in the second quarter, rising by 0.8%, accelerating during the next two quarters to 4.3% and 8.0% respectively. In the first quarter of 2010, the number of working hours per employee started to increase and the growth in productivity per working hour decelerated to 5.6% (see Figure 7).

Productivity per employee started growing only in the fourth quarter of 2009, when it rose by 2.7%; in the first quarter of 2010, growth accelerated to 8.8%. The drop in working hours per employee avoided lay-offs among qualified workers at the cost of above-average under-use of workforce. As the economic situation improved, demand was immediately met by increases in working hours, though employment did not initially increase.



**Figure 7. Annual labour productivity growth**

Compared to other European Union Member States, Estonia saw much more intensive use of the reductions of working hours during the economic decline and increases in them following economic recovery. In most European Union countries, the growth in productivity per working hour nearly equalled the productivity growth per employee. In Estonia and Slovakia, however, productivity per employee grew more than hourly productivity (see Figure 8).

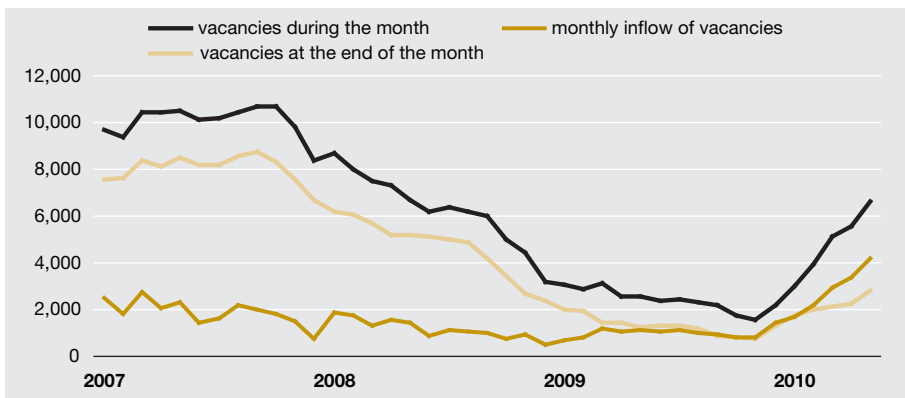


**Figure 8. Annual labour productivity growth in the EU in Q1 2010**

**Vacancies**

According to the Unemployment Insurance Fund's statistics on vacancies, labour demand started to show signs of stabilisation in the second half of 2009. In the first months of 2010,

the number of vacancies started to increase noticeably, reaching positive year-on-year growth in February. The number of valid job offers continued to grow at an accelerating pace and in May the number of vacancies was nearly 2.6 times greater than in the same period of the previous year, and almost equal to the same month in 2008 (see Figure 9). Although the number employed still dropped significantly in the first quarter of this year, the statistics for vacancies indicate that labour demand is recovering.

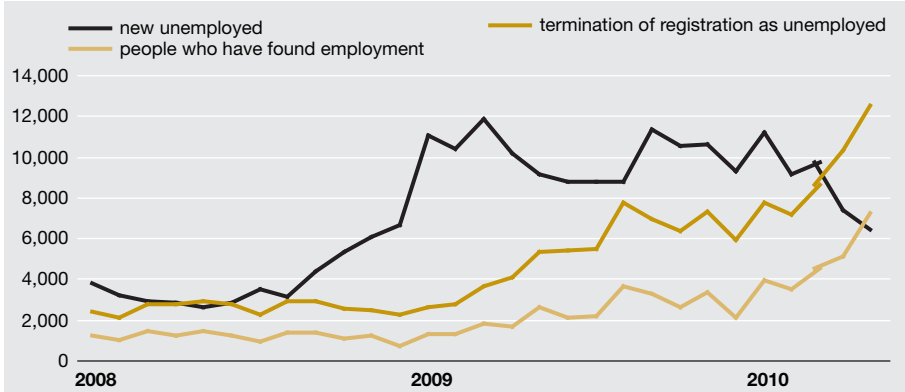


**Figure 9. Vacancies registered in the Unemployment Insurance Fund**

The creation of jobs and the employment of the registered unemployed are currently being supported by active labour market policies and incentives. For instance, in May 1,338 people were employed with the aid of wage subsidies, a number which was 17% more than in the previous month. Although this keeps unemployment from stagnating, subsidised jobs should be replaced smoothly by sustainable ones once the economy recovers. The jobs created during the next five years will be quite different from those created today or in the past five years.

The increasing number of vacancies boosted the employment of the registered unemployed and the termination of registration of people as unemployed for other reasons. In May 2010, 2.7 times as many people were employed as in the same period of the previous year (see Figure 10).

The number of newly employed is greater than the Unemployment Insurance Fund's data show, as not everyone reports their employment and some of the unemployed who do not turn to the Labour Market Board by the set time or who wish to stop being registered as unemployed have already found jobs.



**Figure 10. Monthly changes in the number of unemployed registered in the Unemployment Insurance Fund**

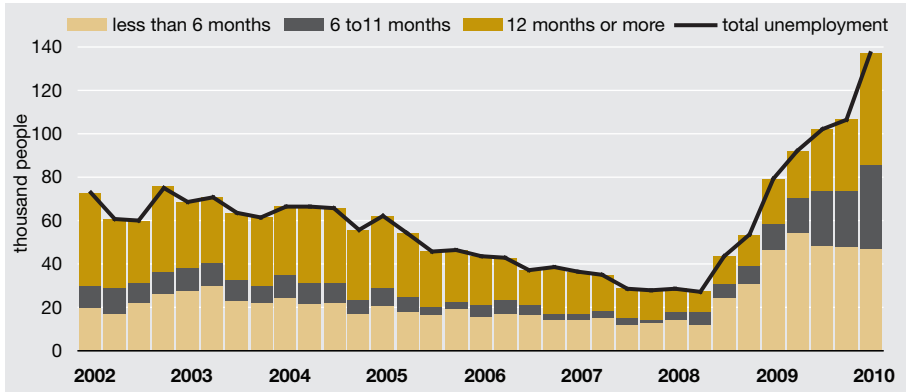
## Unemployment

According to Statistics Estonia, the unemployment rate rose in the first quarter of 2010 to 19.8% and the number unemployed increased to 136,900. Year-on-year unemployment growth peaked in the second quarter of 2009 at 237.7% and has since decelerated gradually, down to 73.3% in the first quarter of 2010. Over two years unemployment rose 4.8 times.

In the first quarter the number of short-term unemployed, which shows those who have been out of work for up to 6 months, fell to 46,900, which is the same as a year previously. However, the number of long-term unemployed increased significantly, with the number of people unemployed for 6–11 months 3.3 times higher than a year previously, and the number of unemployed for 12 months or more 2.5 times higher. This has also raised the proportion of people unemployed for over a year as a share of total unemployment, pushing it up to 37% in the first quarter (see Figure 11).

It is much harder for the long-term unemployed who have been inactive for a longer period of time to return to the labour market. Although total unemployment growth is waning, the number of long-term unemployed will continue to grow for at least 1.5 years.

During the boom, employment growth was particularly rapid among groups that are commonly under-represented, specifically women, the young, the elderly, and non-Estonians. In the middle of 2009 this trend turned, more sharply for the young, less so for women, the elderly and non-



**Figure 11. Short- and long-term unemployed**

Estonians. As men were hit harder by the job losses in construction and manufacturing than were women, the employment rates of men and women became almost equal in 2009, and in the first quarter of 2010 the employment rate of women exceeded that of men for the first time, at 54.1% against 52.8%.

In the first quarter, unemployment for men grew to 25.2% and for women to 14.6%. The unemployment rate for non-Estonians increased dramatically at the beginning of 2009, but after that the relative deterioration in the employment rate for non-Estonians started decreasing. It became larger again in the first quarter of 2010, as employment of non-Estonians dropped to 49.7% while the employment rate for Estonians stood at 55.3%. The key problem for non-Estonians is poor language skills, but regional and structural aspects also play a significant role in their unemployment, with higher employment in construction and manufacturing. In relative terms, the situation deteriorated the most for people aged 15–24, as unemployment in this group grew by 16.1 percentage points over the year to 40.6%. The high level of unemployment among the young is a serious social risk factor, as long-term unemployment may result in the rejection of this age group from the labour market (see Background Information 3).

### **Background Information 3. Negative long-term effects of unemployment among the young**

The global economic crisis was particularly detrimental to young people on the labour market. In OECD countries, the average level of unemployment among the young

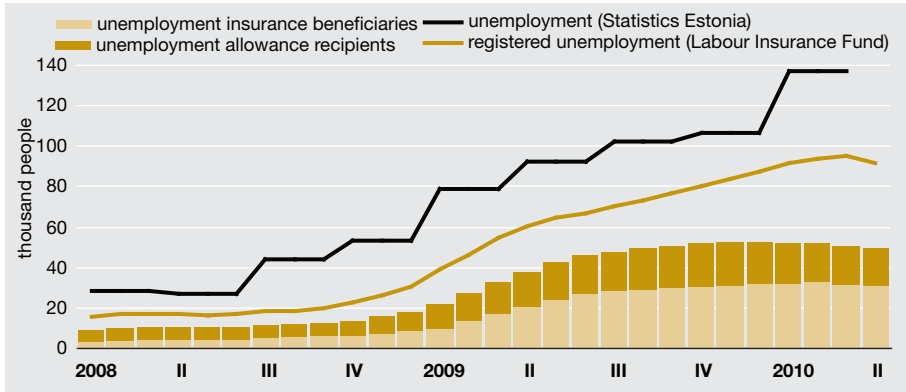
reached 19% at the end of 2009, and in several countries it was even higher. In Estonia, unemployment among the young was also considerably higher than among other risk groups, at 40.6% in the first quarter of 2010. Their future outlook once the labour market starts improving is also less bright than that of others.

Unemployment of the young is considered particularly dangerous because of its long-term negative consequences. Not only does it have a negative effect on their future wages and ability to participate in the labour market, it may also undermine their sense of happiness, their job satisfaction and even their health. In most OECD countries, unemployment among the young is about 2–4 times higher than among the elderly, and the recession has greatly damaged the situation for the young, as the number of those who have lost contact with the labour market has grown rapidly in several countries.

According to OECD experts, most countries have underestimated the danger and the consequences of unemployment among the young and have not done enough to address the issue.

According to the labour survey, changes in registered unemployment do not match the overall assessment of unemployment. Registration is affected not only by general changes in unemployment, but also by the benefits accompanying the registration such as unemployment insurance, unemployment benefits, health insurance and training courses, which seem more or less attractive to the unemployed at different stages of the economic cycle. In the first quarter of 2010, the spread between registered unemployment and total unemployment increased again, as the share of the registered unemployed in total unemployment decreased (see Figure 12). According to the labour survey, in the first quarter the total number unemployed grew by 30,200 quarter-on-quarter, while the registered unemployed increased by only 9,600. This means that the number of people who were looking for a job but did not consider it important to register as unemployed rose by over 20,000 to 43,400 within one quarter. The labour survey calculates that in the fourth quarter of 2009 the registered unemployed accounted for 79% of estimated total unemployment, but in the first quarter of this year the figure was only 68%.

Registration mainly fell as long-term unemployment and unemployment among the young increased. Although long-term unemployment grew by 17,700 quarter-on-quarter in the first quarter, the number of registered long-term unemployed increased by only 9,200, which is 8,500 less. Another large group with discrepancies was the young. According to Statistics



**Figure 12. Unemployment in Estonia**

Estonia, the number of unemployed aged 15–24 grew by 9,300 in one quarter; however, the number of registered unemployed aged 16–24 increased only by 1,700, or 7,600 less. For both groups, registration falls if no benefits are granted, and the long-term unemployed lose the right to benefits, while the young have often not paid unemployment insurance premiums for long enough to be eligible for benefits.

The number of newly registered unemployed who were previously employed also decreased in the first quarter. The reasons for terminating employment that saw the largest falls were the individual decision of the employee, mutual agreement and other reasons. In the first quarter of 2010, the number of those previously employed who were added to the registered unemployed fell by 30% compared to the same period of the previous year.

In the first quarter unemployment insurance benefits were paid to approximately 32,100 people among the registered unemployed, representing 34% of those registered, and unemployment allowances to 19,400 people or 21%. Altogether, only 55% of the registered unemployed, making 38% of all those unemployed, received any kind of benefits, while 85,400 received no benefits because they did not deem it important to register or did not meet the requirements for receiving benefits.

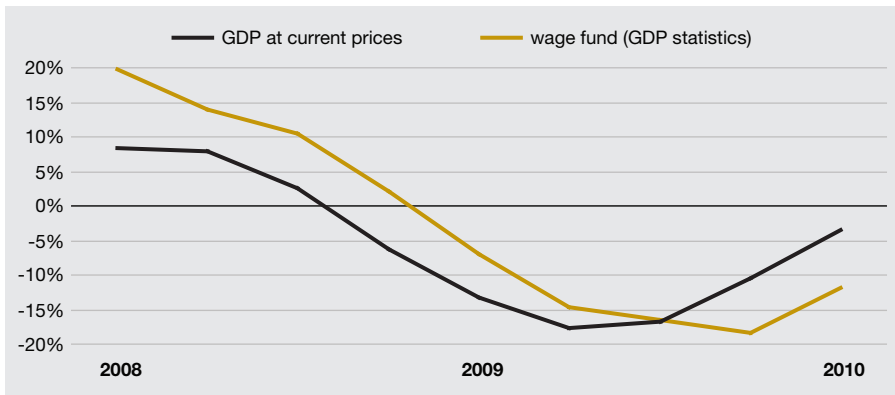
In the second quarter, the number registered as unemployed started to fall steadily, reaching 80,751 on July 1, which nearly equalled the level of October of the previous year and was 14,500 less than at the end of March 2010. This means that within the last three months the number registered as unemployed fell by 15.2%.



## LABOUR COSTS AND PRICE PRESSURES

### Average wages

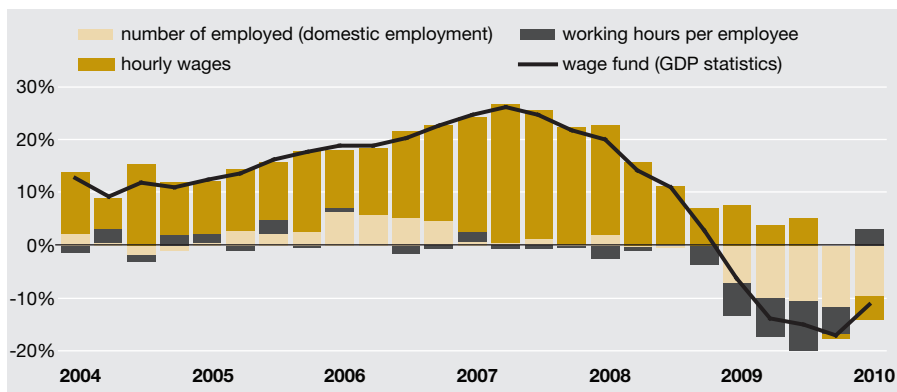
Inertia in wage changes mean that such changes appear later than those in nominal economic growth. Apart from the general inertia, wage payments may also be influenced temporarily during a recession by increased payments arising from lay-offs, unpaid vacations, the use of part-time working hours, and similar factors. Tensions caused by wage pressures already started decreasing gradually in the second half of 2008, but the wage fund grew faster or fell more slowly than the economy as a whole until the third quarter of 2009, or throughout the whole period of deceleration in economic growth and accelerating decline. When the economic decline slowed at the end of last year, the two-quarter inertia of the wage fund persisted and the drop in the wage fund exceeded the drop in GDP (see Figure 13). Wage costs as a share of GDP started decreasing and unit labour costs started shrinking.



**Figure 13. Annual growth of wage fund and GDP at current prices**

In the first quarter of 2010, when the annual fall in GDP in current prices was 3.5%, the annual drop in the wage fund reached 11.9%. As a result the wage fund as a share of GDP fell to 38%, or 3.7 percentage points less than in the same quarter of the previous year or 0.9 percentage points lower than in the first quarter of 2008.

The decomposition of the data for the annual wage fund growth into growth components indicates the impact of each component on the changes in the wage fund (see Figure 14).

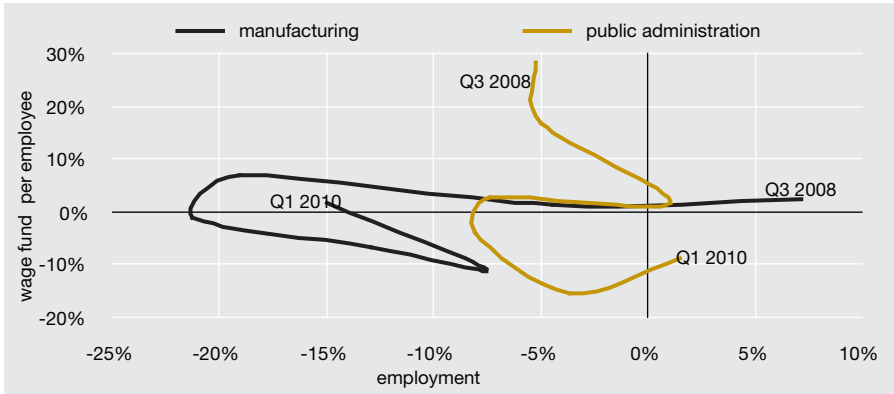


**Figure 14. Annual growth in wage fund by components**

In the pre-boom year 2006, 25% of the increase in the wage fund was caused by rising employment and 75% by wage growth; at the peak of the boom and the beginning of deceleration in 2007-2008, the growth was mainly caused by wage rises. At the end of 2008, the growth in the wage fund slowed down due to cuts in the number of working hours per employee and, as the crisis deepened, also due to the dramatic drop in employment. When the economy recovered in the first quarter of 2010, the drop in employment ended and the number of working hours per employee started to increase. Hourly wages dropped at an accelerating rate of 4.2%, but year-on-year the rate of decrease decelerated to 1.3% per employee.

Movements in average gross monthly wages are slightly different. Average gross monthly wages are calculated in full-time terms per employee, based on employees who have an employment contract and who are employed in accordance with the Public Service Act or on a service contract. Year-on-year, the fall in average gross monthly wages decelerated from 6.5% in the fourth quarter of 2009 to 2.3% in the first quarter of 2010. At the same time, the rate of fall in real wages slowed from 4.6% to 2.6%.

The movements of labour market indicators in the public sector differ from those in the private sector and also tend to have more inertia. While labour costs in manufacturing were mainly curbed by management of employment, in public administration greater adjustments were made in wages (see Figure 15). In the first quarter of 2010, when employment fell by 15%, wages were already starting to increase in manufacturing, but the wages in public administration continued to drop by a further 10% while the numbers employed started rising.



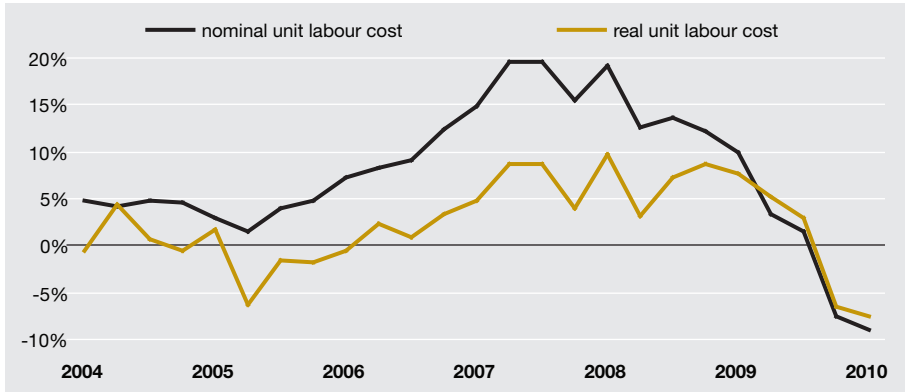
**Figure 15. Wage and employment dynamics in manufacturing and public administration**

### Unit labour costs

The real unit labour cost indicator compares the amount spent per employee, mostly wages and taxes on labour, and labour productivity per employee in current prices. The growth rate of unit labour costs is positive when labour costs per salaried employee grow faster (or drop slower) than labour productivity in nominal terms. Nominal unit labour costs compare labour costs per employee with real productivity, not with productivity calculated at current prices. The aim is to analyse the inflationary pressures arising from wage growth, as companies have to increase the prices of their products in order to retain profitability when wage growth exceeds productivity.

When the economic decline started to slow down, unit labour costs began to fall as expected. In the first quarter, real unit labour costs decreased by 7.5%, while nominal unit labour costs dropped by 8.9% (see Figure 16).

Major adjustments in labour market indicators were necessary and allowed the gap between wages and productivity that had emerged during the boom to be reduced. The shrinking nominal unit labour costs show that the inflationary pressures resulting from wage growth were still negative in the first quarter.



**Figure 16. Unit labour cost growth based on GDP statistics**

### **INSTITUTIONAL CHANGES TO THE LABOUR MARKET**

In 2009, the economic decline in Estonia was especially fast. The government maintained its strict fiscal policy by adopting measures to strengthen the fiscal position. According to the OECD, this helped expand the means available for dealing with the increasing numbers unemployed. During the recession, several reforms that had been drafted earlier were passed in accelerated proceedings, for instance the Labour Market Board and the Unemployment Insurance Fund were unified in 2009, improving the provision of support for the unemployed.

Long-term sustainability was strengthened by the Amendment Act to the State Pension Insurance Act, which made the retirement ages for men and women equal at 65 from 2026. The retirement age will be raised gradually from 2017 by three months every year.

Another important reform was the Labour Market Act passed in the middle of 2009, which made the Estonian labour market one of the most flexible in the OECD. This legislation was part of the so-called flexicurity reform, although the security-related provisions to provide greater unemployment benefits for more people will only come into force in 2013, as financing them requires additional resources. Meanwhile, the new act simplified many rules and liberalised the legislation protecting the employed. The assessment method of the OECD found that the protection of the employed in Estonia used to be less flexible than the OECD average; now, its flexibility is above average and close to that of the English-speaking countries.

Flexibility in OECD countries has usually been improved by reducing the share of open-ended employment contracts and replacing them with fixed-term contracts. In Estonia, however, the

share of fixed-term contracts continues to be the lowest in the OECD, and with the adoption of the new Labour Market Act their usefulness even decreased. The new act states that open-ended contracts may be terminated at much shorter notice than previously and employers have to pay one month's wages as compensation. In addition, the maximum compensation was reduced from four to three months' wages, of which one month's wages is paid by the employer and the rest by the Unemployment Insurance Fund. By OECD standards, working hours are also flexible in Estonia. They should total eight hours per day and 40 hours per week, but employers are entitled to increase them to 48 hours per week for a period of four months if they have acceptable reasons. Pay for overtime may be 1.5 times higher than normal and there are no restrictions on working at weekends. Higher pay is only prescribed for work during national holidays.

During the recession, companies used compulsory part-time employment, but unlike many other OECD countries, Estonia and Slovenia have not subsidised this measure.

The share of taxes in Estonian labour costs is above the OECD average and in recent years it has even grown. The taxation of labour incomes is relatively simple, imposing a flat rate of 21% above the essential non-taxable income threshold, which is higher for families with two or more children. It was planned to reduce the income tax rate to 18% in the future, but during the crisis this process was interrupted for fiscal reasons. In 2009, mandatory social security tax rates were raised from 35% to 39.2% for the employer and from 2% to 4.8% for the employee.

Unemployment insurance in Estonia only covers a small share of the unemployed and is significantly lower than the OECD average. This is because of the relatively strict rules, which say that only those who paid insurance premiums for at least 12 of the the past 36 months and did not resign of their own accord or by agreement with the employer are entitled to receive unemployment insurance benefit. In many European countries and the United States, the number of months required is smaller, mostly six months, and the clause concerning voluntary resignation is qualified with multiple exceptions. Some countries also offer unemployment insurance for employees in micro-enterprises, or companies with one employee. The maximum duration that insurance benefits can be received in Estonia is similar to the OECD average.

Generally it may be concluded that many correct measures were taken in Estonia, enabling us to cope with the consequences of the crisis more successfully. Following the recovery from the economic crisis however, more emphasis should be laid on long-term and sustainable development strategies. Countries that opted for the strategy of large-scale subsidies are now finding this measure difficult to terminate. In Estonia, strict fiscal policy requirements must remain a priority, but this calls for more efficient labour market policies.

Active labour market policy measures should focus on the various target groups, and assessment of the measures should be based on their success rather than their size. For companies, a transfer from partially subsidised jobs to more sustainable ones should be guaranteed, while for the unemployed, their eligibility for benefits should also be tied to their readiness actively to take steps.